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In the Supreme Court of the United States

OCTOBER TERM, 1948

Nos. 373–385

GEORGE WHITNEY, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

AND 12 CONSOLIDATED CASES

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 4a–31a) are reported at 8 T. C. 1019. The opinion of the Court of Appeals (R. 257a–274a) is reported at 169 F. 2d 562.

JURISDICTION

The judgments of the Court of Appeals were entered on August 11, 1948. (R. 275a–300a.) A petition for writs of certiorari was filed on Octo-

ber 29, 1948. The jurisdiction of this Court is conferred by 28 U. S. C. 1254.

QUESTION PRESENTED

The taxpayers were members of a partnership which, preparatory to dissolution, sold a substantial amount of its assets to a corporation (the majority of whose capital stock was owned by the taxpayers) which was to continue the business.

Was the Court of Appeals correct in holding that Section 24 (b) (1) (B) of the Internal Revenue Code prohibits the taxpayers from taking a deduction for losses resulting from the sale?

STATUTE INVOLVED

The applicable provisions of the statute involved are set forth in the Appendix, *infra*, pp. 14–17.

STATEMENT

These consolidated proceedings involve asserted deficiencies in individual income taxes for the calendar year 1940. The thirteen taxpayers[1] were partners in the firm of J. P. Morgan & Company. After many years of carrying on the banking business through a partnership, the partners decided to utilize the corporate form. Accord-

[1] Although some of the taxpayers filed joint returns and some are estates of deceased partners, for convenience the partners will be referred to as though they were the only taxpayers. The names of all the taxpayers are set forth in the captions to the judgments entered by the Court of Appeals. (R. 275a–300a.)

ingly, a corporation was duly organized and its stock was issued to the taxpayers and others for cash. The taxpayers acquired more than 72 percent of the stock and their relatives acquired more than 5 percent. (R. 6a, 8a–9a.)

On March 30, 1940, after the corporation had been organized and its stock subscribed for, most of the assets used by the partnership in the banking business (having a value in excess of $597,000,000) were transferred to the corporation. The corporation agreed to assume certain outstanding liabilities of the partnership and the difference in value, amounting to more than $12,000,000, was paid by the corporation to the partnership. On the same day, the partnership paid over substantially the same amount in cash to the corporation to the credit of the individual personal accounts of the thirteen partners. (R. 6a–8a.) The assets were transferred from the partnership to the corporation pursuant to a bill of sale which was signed in the partnership name and by the thirteen partners, individually. (R. 8a, Pet. Ex. 25, R. 224a–237a.)

The sale of assets to the corporation resulted in certain gains and certain losses. Each of the individual partners, in his income tax return for 1940, claimed his distributive share of the losses as well as of the gains. The Commissioner asserted tax deficiencies which resulted, in part, from his determination that the individual partners could not claim any part of the losses as

The broad legislative purpose of denying deductions where genuine economic losses might be absent—a purpose attested to by the *McWilliams* decision and by the history of the section [3]—did not fall wide of the legislative mark in the area covered by this case. The contrary contention of the taxpayers, namely, that Congress purposefully excluded dealings between a partnership and a corporation controlled by the partners (Pet. 9; Br. 13–16) is not only unsupported by any particular matters of legislative history, but is contrary to the whole tenor of the legislative intent which bears on the specific subject matter.

Congress was undeniably disturbed by instances where, for the purpose of establishing tax losses, one business partner would route individual transactions through his partner's closed corporation or personal holding company. See Hearings before the Joint Committee on Tax Evasion and Avoidance, 75th Cong., 1st Sess., Part 2, pp. 216–218. Because of this, the Joint Committee stated (H. Doc. No. 337, 75th Cong., 1st Sess., p. 14):

> Because of the close relationship existing between partners, your committee

[3] House Committee Print, Prevention of Tax Avoidance, Preliminary Report of a Subcommittee of the Committee on Ways and Means, 73d Cong., 2d Sess., pp. 14–15; H. Rep. No. 704, 73d Cong., 2d Sess., p. 23 (1939–1 Cum. Bull. (Part 2) 554, 571); S. Rep. No. 558, 73d Cong., 2d Sess., p. 27 (1939–1 Cum. Bull. (Part 2) 586, 607); Report of Joint Committee of Congress on Tax Evasion and Avoidance, H. Doc. No. 337, 75th Cong., 1st Sess., pp. 14–15; H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 26–29 (1939–1 Cum. Bull. (Part 2) 704, 722–724).

> recommends that losses should be disallowed between an individual and his partner's corporation if such individual owns stock in such corporation.

This recommendation was adopted and incorporated in the 1937 amendments to the basic section.[3]

Having acted to deny losses on transactions where one partner, individually, sells property to a corporation in which he holds a small amount of stock but in which his partner owns the controlling stock interest, it is inconceivable that Congress should have specifically intended, as the taxpayers assert, to permit such losses to be deducted if the property transferred to the corporation consists of partnership property. Actually, situations like the present case are more compelling for denying loss deductions than the one which Congress corrected in 1937. For, when partnership property is transferred to a corporation controlled by the partners, each partner suffers even less (if any) genuine economic loss than is true where one partner sells his individual property to a corporation dominated by his partner. In the former, the investment of the individual continues in another form; in the latter, it may have been largely terminated. There is no basis for concluding that Congress expressly acted to deny loss deductions in one

[3] Section 301, Revenue Act of 1937, c. 815, 50 Stat. 813. See H. Rep. No. 1546, 75th Cong., 1st Sess., pp. 26–29 (1939–1 Cum. Bull. (Part 2) 704, 722–724).

situation involving partners, but intended to permit such deductions to be taken by the partners in circumstances where the reasons calling for denial of the deductions are more clearly present. It is true that Section 24 (b) (1) (B) does not cover all instances where artificial losses might exist (Pet. Br. 14); it seems plain, however, that the relationship between partners, partnerships, and corporations controlled by them was not one of the omitted areas.[4]

We may briefly refer to other matters which persuasively confirm the construction of the statute upheld by the Court of Appeals. Section 24 (b) (1) (B) would prevent deductions for losses when business property of a syndicate, group, pool, or joint venture is sold to a corporation controlled by the members who constitute the organization.[5] Clearly this section cannot draw distinctions between such sales and sales of partnership property to a corporation controlled by the partners. This is so because Congress, for all income tax purposes, has defined the term

[4] Lest an erroneous impression be created by the taxpayers' assertions (Pet. 8–9; Br. 12–13), we wish to make plain our position that there would not be any deductible losses on a sale of property from one partnership to another firm composed of identical partners. There would not even be a realization of loss in such a situation which would be tantamount to a transfer from a group of persons back to themselves.

[5] The taxpayers agree that this is the proper interpretation of Section 24 (b) (1) (B). See their reply brief in the Court of Appeals, pp. 11–12.

"partnership" as including these other kinds of business organizations where the members are joint owners of the business assets and has defined the term "partner" as including a member of any of these organizations. Section 3797 (a) (2), Internal Revenue Code (Appendix, *infra*). Accordingly, it seems plain, as the court below noted (R. 265a–266a), that Congress would have had no rational purpose in distinguishing between the members of these various business organizations for the purpose of permitting to some, but denying to others, the very same kind of loss deductions. Further, the fact that Section 24 (b) (1) (B) covers sales or exchanges made "directly or indirectly" is persuasive that the correct interpretation of the congressional intent is not to be achieved by the narrow approach advocated by the taxpayers which assigns niggardly values to statutory language intended to have broader implications.

Finally, it cannot be successfully contended that Congress failed in achieving its purpose because of an asserted neglect to employ the proper language in the statute. Section 24 (b) (1) (B), in disallowing loss deductions arising out of sales made by an "individual", used language sufficiently apt to describe sales of partnership property. In taxing partnership income to the partners, rather than to the partnership, Congress elsewhere in the taxing statute (Secs. 181–183, Appendix, *infra*) considers the partners as the

owners of the partnership property. See: Rabkin and Johnson, *Federal Taxation of Partnerships,* 55 Harv. L. Rev. 909, 915 (1942). The mechanics of the statutory scheme are actually apparent from the fact that here it is the individual partners who are claiming the loss deductions in their tax returns. It is not surprising, therefore, that in Section 24 (b) (1) (B), Congress should have also viewed a sale by the partnership as being no more than a sale by the individual partners, the same as would be true of other joint owners. This is particularly so because of the definitions contained in Section 3797 (a) (2) which, as has already been mentioned, places in the category of partners all kinds of joint owners of business property. And, while local law may have played no decisive part in the concepts employed in the taxing statute, it is significant that local law would regard the sale here as having been made by the partners. That is, it is undisputed that the express assent of all the individual partners is required to effectuate a sale of partnership assets which would make it impossible for the firm to continue in business. That assent was manifested in this case by the fact that each of taxpayers individually signed the bill of sale. Consequently, it was not unsuitable for Congress to describe the sale here as made "directly or indirectly" by the individual partners.

2. The issue decided by this case does not involve "the true status of a partnership for tax

purposes." (Pet. 5.) The decision below does not constitute a ruling, as a matter of general law, on the nature of partnerships or on the ownership of partnership assets. (Pet. 7–8; Br. 17–18.) Nor does it purport to draw universal conclusions concerning partnership matters which would necessarily possess uniform applicability throughout the taxing statute. (Pet. 5–6.) The present case decides no more than the meaning of Section 24 (b) (1) (B) as it relates to circumstances where partners, in liquidating their partnership business, caused the partnership assets to be transferred to a corporation controlled by them. As the court below pointed out, the questions which the taxpayers raise (R. 262a) "are fascinating in their possibilities for semantic dispute." But neither they nor any other aspects of a (R. 262a) "jurisprudential debate" are decisive of the question of statutory construction, which is the only issue here. Conversely, a decision relating to the correct interpretation of Section 24 (b) (1) (B) does not provide definitive answers to the problems raised by the taxpayers, important as they may be. For example, whether Section 24 (b) (1) (B) disallows a deduction for the losses in this case does not at all determine questions like that presented in *Commissioner* v. *Lehman,* 165 F. 2d 383 (C. C. A. 2d), certiorari denied, 334 U. S. 819, which involved an important question concerning one aspect of the taxable status of a partner's interest in the partnership business.

The taxpayers' contentions that the reversal of the Tax Court (Pet. 6) "plainly violated the rule of" *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231, and that (Br. 19) "there was a rational basis" for the Tax Court's conclusion, seem calculated to give the case an exaggerated importance. The very same section of the statute was presented for construction in *McWilliams* v. *Commissioner, supra,* and the Court there (p. 703) expressly rejected the contention that *Dobson* controlled. Accordingly, the Tax Court's erroneous construction of the statute here was no more precluded from judicial review than it was in the *McWilliams* case. Since the Court of Appeals was empowered to reverse under the statutory provisions in effect when the case was decided, it is plain that any problems that might be presented by the amendment to Section 1141 (a) of the Internal Revenue Code,[6] which first became effective September 1, 1948, are purely academic to this case. The amendment to Section 1141 (a), moreover, was designed to broaden, not restrict the authority of the reviewing courts.

3. There is no conflict in decisions. *Case* v. *Beauregard,* 99 U. S. 119, and *Blodgett* v. *Silberman,* 277 U. S. 1, the only decisions relied on by the taxpayers (Pet. 7–8; Br. 17–18), plainly have nothing to do with the case at hand. The

[6] Section 1141 (a) was amended by Section 36 of the Act of June 25, 1948, Public Law 773, 80th Cong., 2d Sess.

former, which dealt with the rights of firm creditors to property which had been conveyed by the partners, and the latter, dealing with the constitutional authority of a state to impose a transfer tax, do not possess any significance in determining congressional intent within the framework of the statutory provisions which were construed by the lower court here. Nor is there any warrant for the assertion that the court below (Br. 17) "repudiated even its own prior decision in *Commissioner* v. *Lehman.*" While we think that the *Lehman* decision is wrong, the two cases, dealing as they do with totally different problems, are not at all inconsistent in result, and the court below did not purport even to question the decision in the *Lehman* case. (R. 267a–269a.)

CONCLUSION

The petition for writs of certiorari should be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
LEE A. JACKSON,
HILBERT P. ZARKY,
Special Assistants to the Attorney General.

NOVEMBER, 1948.

APPENDIX

Internal Revenue Code:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

* * * * *

(e) *Losses by Individuals.*—In the case of an individual, losses sustained during the taxable year and not compensated for by insurance or otherwise—

(1) if incurred in trade or business; or

(2) if incurred in any transaction entered into for profit, though not connected with the trade or business; or

* * * * *

(26 U. S. C. 1946 ed., Sec. 23.)

SEC. 24. ITEMS NOT DEDUCTIBLE.

* * * * *

(b) *Losses from Sales or Exchanges of Property.*—

(1) *Losses Disallowed.*—In computing net income no deduction shall in any case be allowed in respect of losses from sales or exchanges of property, directly or indirectly—

(A) Between members of a family, as defined in paragraph (2) (D);

(B) Except in the case of distributions in liquidation, between an individual and a corporation more than 50 per centum in value of the outstanding stock of which is owned, directly or indirectly, by or for such individual;

(C) Except in the case of distributions in liquidation, between two corporations more than 50 per centum in value of the outstanding stock of each

of which is owned, directly or indirectly, by or for the same individual, if either one of such corporations, with respect to the taxable year of the corporation preceding the date of the sale or exchange was, under the law applicable to such taxable year, a personal holding company or a foreign personal holding company;

(D) Between a grantor and a fiduciary of any trust;

(E) Between the fiduciary of a trust and the fiduciary of another trust, if the same person is a grantor with respect to each trust; or

(F) Between a fiduciary of a trust and a beneficiary of such trust.

* * * * *

(26 U. S. C. 1946 ed., Sec. 24.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1946 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

(a) As a part of his short-term capital gains or losses, his distributive share of the net short-term capital gain or loss of the partnership.

(b) As a part of his long-term capital gains or losses, his distributive share of the net long-term capital gain or loss of the partnership.

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b).

SEC. 183. COMPUTATION OF PARTNERSHIP INCOME.

(a) *General Rule.*—The net income of the partnership shall be computed in the same manner and on the same basis as in the case of an individual, except as provided in subsections (b) and (c).

(b) *Segregation of Items.*—

(1) *Capital Gains and Losses.*—There shall be segregated the short-term capital gains and losses and the long-term capital gains and losses, and the net short-term capital gain or loss and the net long-term capital gain or loss shall be computed.

(2) *Ordinary Net Income or Loss.*—After excluding all items of either short-term or long-term capital gain or loss, there shall be computed—

(A) An ordinary net income which shall consist of the excess of the gross income over the deductions; or

(B) An ordinary net loss which shall consist of the excess of the deductions over the gross income.

(c) *Charitable Contributions.*—In computing the net income of the partnership the so-called "charitable contribution" deduction allowed by section 23 (o) shall not be allowed; but each partner shall be considered as having made payment, within his taxable year, of his distributive portion of any contribution or gift, payment of which made by the partnership within its taxable year, of the character which would be allowed to the partnership as a deduction under such section if this subsection had not been enacted.

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1946 ed., Sec. 3797.)

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